STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**05/24/04**	Bill No:	**SB 1774**
Tax:	**Sales and Use** **Bradley-Burns Local**	Author:	**Johnson and Torlakson**
Board Position:		Related Bills:	**SCA 21 (Torlakson, et al)** **SCA 22 (Johnson, et al)** **AB 3105 (Campbell, et al)** **ACA 30 (Steinberg, et al)**

BILL SUMMARY

Among its provisions, this bill would, on and after July 1, 2005:

- Increase the state sales and use tax rate by 0.25 percent (this increase is in addition to the 0.25 percent increase as part of the “Triple Flip”);
- Provide that the revenues from the 0.25 percent increase be deposited into the School Assistance Fund for Education Sales and Use Tax Revenue Account that this bill creates;
- Decrease the local sales and use tax rate imposed by a city or a county by a 0.25 percent (this decrease is in addition to the 0.25 percent reduction as part of the “Triple Flip”);

Although this bill affects property tax and sales and use tax, this analysis will deal primarily with the sales and use tax provisions. The property tax provisions will be discussed generally only because it is related to the sales tax provisions in this bill, but it is not within the scope of administration by the Board.

Summary of Amendments

Since the previous analysis, this bill was amended to delete the provision that would, for a specified period, authorize a city or county to request that its property tax revenue allocation be increased by the new development adjustment amount, as defined

ANALYSIS

Current Law

The Sales and Use Taxes Law (commencing with Section 6001 of the Revenue and Taxation Code), provides that a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased from a retailer. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted or excluded from the tax.

Currently, the statewide sales and use tax rate is 7.25 percent. Of the 7.25 percent base rate, 6 percent is the state portion and 1.25 percent is the local portion. However, beginning July 1, 2004, the state tax rate will increase by 0.25 percent, from 6 to 6.25 percent, and the local tax rate will decrease by 0.25 percent, from 1.25 to 1 percent. The revenues from the 0.25 percent state tax rate increase are to be deposited into the Fiscal

Recovery Fund and dedicated to the repayment of the deficit bonds.

The components of the state sales and use tax rate of 6 percent are as follows:

- 4.75 percent is allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051 and 6201 of the Revenue and Taxation Code);
- 0.25 percent is allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051.3 and 6201.3 of the Revenue and Taxation Code);
- 0.50 percent is allocated to the Local Revenue Fund which is dedicated to local governments to fund health and welfare programs (Sections 6051.2 and 6201.2 of the Revenue and Taxation Code);
- 0.50 percent is allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).

The Bradley-Burns Uniform Local Sales and Use Tax Law (commencing with Section 7200 of the Revenue and Taxation Code), authorizes a county to impose a local sales and use tax at a rate of 1.25 percent, and similarly authorizes a city to impose a local sales and use tax rate of 1 percent that is credited against the county rate. Beginning on July 1, 2004, existing law reduces by 0.25 percent the rate that may be imposed by a county, from 1.25 to 1 percent, and by a city, from 1 to 0.75 percent. Existing law also provides that this reduction in the local tax rate will be increased by 0.25 percent when the Department of Finance (DOF) has made a specified notification to the Board, pursuant to Section 99006 of the Government Code, that the $15 billion bond has been repaid.

Proposed Law

This bill would, among other things, do the following:

1) Create a State School Assistance Fund for Education (SAFE) in the State Treasury that would consist of 2 accounts: a SAFE Sales and Use Tax Revenue Account and a SAFE Vehicle License Fee Law Account. With respect to the revenues deposited into the 2 SAFE accounts:
   - Specify that taxes imposed under Sections 6051.7, 6051.9, 6201.7, and 6201.9 of the Revenue and Taxation Code are to be deposited into the SAFE Sales and Use Tax Account.
   - Specify that fees imposed under Section 11007 of the Revenue and Taxation Code be deposited into the SAFE Vehicle License Fee Law Account.
   - Require the Board to notify the State Controller by the 26th of each month the amount of revenue attributable to each county from the taxes imposed under Sections 6051.7, 6051.9, 6201.7, and 6201.9.
2) Add Sections 6051.7 and 6201.7 to the Revenue and Taxation Code to impose an additional 0.25 percent state sales and use tax. All revenues derived from this tax would be deposited into the SAFE Sales and Use Tax Revenue Account in the State Treasury. This bill requires that the taxes imposed under this section would be collected by the Board and deposited on or before the 15th day of each month in the SAFE Sales and Use Tax Account and provides that this tax is not imposed on sales or

purchases of tangible personal property, other than fuel or petroleum products, to aircraft common carriers.

3) Amend Sections 7202 and 7203 of the Revenue and Taxation Code to: reduce the local sales and use tax rate by 0.25 percent; provide that the rate imposed by a county is 0.75 percent and that the rate imposed by a city is 0.50 percent or less; and provide that sales or purchases of tangible property made to aircraft common carriers are exempt from 67 percent of the local sales or use tax.

4) Amend Section 29530 of the Government Code (0.25 percent county transportation tax) to conform to the provisions of Sections 7202 and 7203 of the Revenue and Taxation Code.

5) Repeal Section 7203.1 of the Revenue and Taxation Code, effective July 1, 2005, to reduce the local sales and use tax rate by 0.25 percent, instead of increasing that rate by 0.25 percent when the DOF notifies the Board that the bond had been repaid. (This bill, once the revenue exchange period has ended, permanently reduces the local sales and use tax rate by a 0.25 percent for a total reduction of 0.50 percent.)

6) Add Sections 6051.9 and 6201.9 to the Revenue and Taxation Code to impose an additional 0.25 percent state sales and use tax. All revenues derived from this tax would be deposited into the SAFE Sales and Use Tax Revenue Account in the State Treasury. These provisions would become operative on the first day of the first calendar quarter commencing more than 90 days after the DOF notifies the Board pursuant to Section 99006 of the Government Code that the $15 billion bond has been repaid and/or there is sufficient money in the Fiscal Recovery Fund to repay the bond.

7) Add Sections 97.68 and 97.69 to the Revenue and Taxation Code to modify the formulas used to allocate property tax revenues. Specifically, this bill would require the following:

   - On or before July 15, 2005, the Board shall notify each city and county of the amount of revenue that would have been transmitted to the city and county for the 2004-05 fiscal year, if the local tax rate imposed by a county was 0.75 percent and by a city was 0.50 percent.
   - On or before August 15, 2005, the DOF shall, in consultation with the Board, determine the actual local sales and use tax revenue losses during the 2004-05 fiscal year resulting from the 0.25 percent reduction in the local tax rate.

The provisions of this bill would become operative July 1, 2005.

This bill would become effective only if SCA 22 of the 2003-04 Legislative Session is approved by the voters at the November 2, 2004, statewide general election. Among its provisions, SCA 22 would enact the Local Government Property Tax Protection Act of 2004 to create a SAFE account in each county to receive revenues from specified state sales and use tax rates and revenues from vehicle license fees. This bill would specify that an act of the Legislature or Governor may not reduce the amount of monies that are required to be appropriated to county SAFE's, unless that act makes a continuous appropriation in an amount equal to the reduction.

Background

"The fiscalization of land use" refers to the concept of examining land use decisions in the context of their revenue and expenditure consequences. Because Proposition 13 reduced the revenues that would be received from property taxes from any particular development (industrial, commercial, or residential), local jurisdictions began to pay even more attention to the fiscal outcomes of land use decisions, and those uses that generated revenues in addition to property taxes have been elevated in importance.

The decision by local governments to utilize land for retail sales in order to generate sales tax revenues is one example of the fiscalization of land use. Local governments have engaged in numerous activities to encourage retail activity in their jurisdiction, such as zoning excessively for retail, providing sales tax rebates to retailers who locate in their jurisdiction, waiving developer fees, and expediting the permit process.

This bill is intended to address, among other issues, the fierce competition that local entities are now facing in getting as much local (1.0%) sales and use tax revenue as they can.

In General

Several bills have been introduced in recent years related to local tax revenue restructuring. Two bills introduced during the 2001-2002 Legislative Session contained provisions pertaining to local tax allocations. Assembly Bill 680 (Steinberg) would have changed the allocation method of the 1 percent local sales tax in El Dorado, Placer, Sacramento, Sutter, Yolo, and Yuba counties. Assembly Bill 2878 (Wiggins) would have modified the property tax allocation to a city or county, provide that a city may not impose a sales and use tax rate in excess of 0.85 percent except under specified circumstances, and prohibit the state from transferring money from the General Fund to cities and counties to fund vehicle license fee offsets.

Two bills introduced during the 2003-04 Legislative Session also contained provisions related to local tax allocations and restructuring. Assembly Bill 1221 (Steinberg and Campbell), among its provisions, would have: (1) decreased the local sales and use tax rate imposed by a city from 1 percent to 0.50 percent; (2) decreased the local sales and use tax rate imposed by a county from 1.25 percent to 0.75 percent; (3) as of July 1 of the base fiscal year, as defined, increased the amount of property tax revenue allocated to a county by that county's or city's reimbursement amount, as defined, and correspondingly decrease the amount of property tax revenue allocated to a county's Educational Revenue Augmentation Fund by the countywide adjustment amount, as defined; and (4) allowed cities and counties to adjust their base fiscal year reimbursement amounts, as specified. ACA 17 (Daucher) would have, among other things, authorized a city or a county to irrevocably elect to increase its property tax revenue by an amount equal to its local sales and use tax revenue attributable to a rate of 0.50 percent, and would have required that the county's ERAF be reduced by the same amount. The cities' and counties' local sales and use tax revenues attributable to a rate of 0.50 percent would be used to backfill the counties' ERAF.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the authors in an effort to restructure the flow of property tax, local sales tax, and vehicle license fee revenues to local governments.

2. **The May 24, 2004 amendments** would do the following: (1) delete the provision that would, for the period January 1, 2005 through December 31, 2007, authorize a city or county to request that its property tax revenue allocation be increased by the new development adjustment amount, as defined; and (2) provide that no state mandate reimbursement is required by this act pursuant to the California Constitution because the duties imposed on a local agency or school district by this act are expressly included in SCA 22 (this bill becomes operative only if SCA 22 is approved by the voters at the November 2, 2004 statewide general election.)

3. **Technical amendment may be necessary.** This bill would require the Board, by July 15, 2005, to notify each city and county the amount of revenue that would have been transmitted to the city and county for the 2004-05 fiscal year, if the local tax rate imposed by a county had been 0.75 percent and had been 0.50 percent by a city. The deadline of July 15, 2005 does not give Board staff enough time to notify cities and counties. Board staff anticipates that the information could be provided by August 15 or September 1st.

4. **Under the "Triple Flip," partial tax exemptions were not subject to the new 0.25 percent state sales and use tax rate which becomes operative on July 1, 2004. The same problem exists here.** Under the "Triple Flip," no provision was made excluding the partial tax exemption from the new 0.25 percent state sales and use tax rate (revenues dedicated to the repayment of the deficit bonds). This meant that tangible personal property qualifying for the partial tax exemptions got an additional 0.25 percent exemption. The partial sales and use tax exemptions include: farm equipment and machinery, timber harvesting equipment and machinery, diesel fuel used in farming activities and food processing, racehorse breeding stock, manufacturing equipment, teleproduction and post production activities. These partial tax exemption statutes contain provisions that exclude the exemptions from any taxes levied pursuant to Bradley-Burns Uniform Local Sales and Use Tax Law and Transactions and Use Tax Law. These partial tax exemptions also do not apply to taxes levied pursuant to Section 6051.2 and 6201.2 of the Revenue and Taxation Code (also known as the Local Revenue Fund tax), and pursuant to Section 35 of Article XIII of the California Constitution (also known as the Local Public Safety Fund tax).

   Thus, the partial tax exemption statutes apply only to the state General Fund portion of the sales and use tax rate. The state General Fund portion is currently 5 percent. However, beginning July 1, 2004, the state portion of the sales and use tax rate increases by 0.25 percent. The revenues derived from this state tax rate increase are to be deposited into the Fiscal Recovery Fund and dedicated to the repayment of the deficit bonds. Because no provision was made excluding the partial tax exemptions from this new 0.25 percent state sales and use tax rate, the partial exemptions will increase from 5 to 5.25 percent on July 1, 2004.

   With respect to Bradley-Burns local taxes, district taxes, and the two 0.5 percent statewide local taxes (Local Revenue Fund and Local Public Safety Fund), there is no partial tax exemption that applies to these taxes.

5. **New state sales and use tax rate of 0.25 percent will not be included in the calculation of the sales tax prepayment rate on gasoline, diesel fuel, and aircraft jet fuel.** Suppliers and wholesalers of motor vehicle fuel (gasoline), diesel fuel, and aircraft jet fuel are required to collect a prepayment of a portion of the sales tax when they remove fuel at the terminal rack, enter the fuel into California, or sell the fuels at any point after removal from the terminal rack. Section 6480.1 of the Revenue and Taxation Code requires the Board to establish the sales tax prepayment rates based upon 80 percent of the combined state and local sales tax rate established by Sections 6051, 6051.2, 6051.3, and 7202 of the Revenue and Taxation Code and Section 35 of Article XIII of the California Constitution on the average selling price as determined by the State Energy Resources Conservation and Development Commission in its latest publication of the Quarterly Oil Report. The prepayment of sales tax was enacted to deter the underreporting of taxable sales of fuel. With a prepayment of tax there is no incentive to underreport sales since the retailer needs to recapture the amount of tax already paid to their supplier.

   Effective April 1, 2004, the prepayment rates for fuels (per gallon) are as follows: gasoline at a rate of $0.09 per gallon, diesel fuel at a rate of $0.07 per gallon, and aircraft jet fuel at a rate of $0.045 per gallon. These rates are scheduled to remain in effect through March 31, 2005. If the price of these fuels increases or decreases and results in prepayments that consistently exceed or are significantly lower than the fuel retailer's sales tax liability, the Board may adjust these rates. The Board is required, by November 1 of each year, to establish the prepayment tax rate for these fuels.

   Because Section 6480.1 includes the specific code sections of each state and local tax component, the new 0.25 percent tax should to be added to the statute in order for the prepayment rate to capture total state tax rate. Without this amendment, the prepayment rate will be based on a total tax rate of 7 percent, instead of the current 7.25 percent. The effect is that retailers will pay a lower prepayment amount which could lead to the underreporting of taxable sales. Without a representative prepayment amount, there is an incentive to underreport taxable sales.

   Senate Bill 1881 (SR&T) contains provisions to fix this same problem with regard to the original Triple Flip tax rate change.

6. **Related legislation.** Among its provisions, **SCA 22 (Johnson and Torlakson)**, which is joined to this bill, would enact the Local Government Property Tax Protection Act of 2004 to create a SAFE account in each county to receive revenues from specified state sales and use tax rates and revenues from vehicle license fees. This bill would specify that an act of the Legislature or Governor may not reduce the amount of monies that are required to be appropriated to county SAFE's, unless that act makes a continuous appropriation in an amount equal to the reduction. **AB 3105 (Campbell and Steinberg)** is identical to this bill. Also, **ACA 30 (Steinberg and Campbell)** is identical to SCA 22.

   SCA 21 (Torlakson and Johnson) would, among other things, enact the Local Taxpayers and Public Safety Protection Act to require statewide voter approval for any legislative measure that would, as specified, affect the revenue streams to local governments.

COST ESTIMATE

Changes to the tax rates have a substantial impact on the Board's administrative costs. Tax returns and various Board publications would have to be revised to reflect the new rate changes. Programming and data entry would also be necessary to reflect the new rates, in addition to costs to notify all taxpayers registered with the Board prior to the rate changes.

A detailed cost estimate is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

The Sales and Use Tax Law imposes a tax on the gross receipts from the sale, the storage, use, or other consumption in this state of, tangible personal property. Beginning July 1, 2004, and continuing until a specified date after the DOF makes a specified notification to the Board, that law imposes an additional state sales and use tax at the rate of 0.25 percent.

This bill would, in addition to any other sales and use tax rates imposed by law, impose a state sales and use tax at the rate of 0.25 percent. This revenue would be deposited in the SAFE Sales and Use Tax Revenue Account. This bill would, on and after the specified date after the DOF's notification to the Board that the fiscal recovery period has ended, impose an additional state sales and use tax at the rate of 0.25 percent that would be deposited into the same account.

We should note that the 0.25 percent state tax rate increase as proposed by this bill will not increase the overall state and local sales and use tax rate. It only shifts $1.2 billion in sales and use tax revenue from Bradley-Burns to the state, net of partial exemptions.

There are currently six partial exemptions in the Revenue and Taxation Code. Effective July 1, 2004, they are exempt from the 5.25 percent state tax, but not the Bradley-Burns local taxes, district taxes, and the two 0.5 percent statewide local taxes (Local Revenue Fund and Local Public Safety Fund). The exemptions are:

Section 6356.5	Farm equipment and machinery
Section 6356.6	Timber harvesting equipment
Section 6357.7	Diesel fuel used in farming and food processing
Section 6358.5	Racehorse breeding stock
Section 6378	Property used in teleproduction and postproduction
Section 6378.1	Rural investment tax exemption

Beginning on July 1, 2005, this bill would increase those partial exemptions by 0.25 percent, from 5.25 percent to 5.50 percent. Estimated sales transactions applicable to these exemption for the four quarters ending September 30, 2003 are as follows:

Exemptions	**Exempt Transactions**
Farm Equipment	$ 1344 million
Timber Harvesting Equipment	$ 26 million
Diesel Fuel – Farming & Food Processing	$ 370 million
Racehorse Breeding Stock	$ 11 million
Teleproduction Equipment	$ 242 million
Total	$1993 million

Revenue Summary

Beginning on July 1, 2005, a state sales and use tax rate increase of 0.25 percent would increase the partial exemptions this same amount. This would reduce the state sales tax receipts by $5 million annually ($1993 million x 0.25 percent).

The revenue shift from the Bradley-Burns local tax to the state would be $1.2 billion annually.

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